



C.D. Howe Institute
Institut C.D. Howe

e-brief

Raise Electricity Prices in Quebec — and Benefit Everyone

By Marcel Boyer

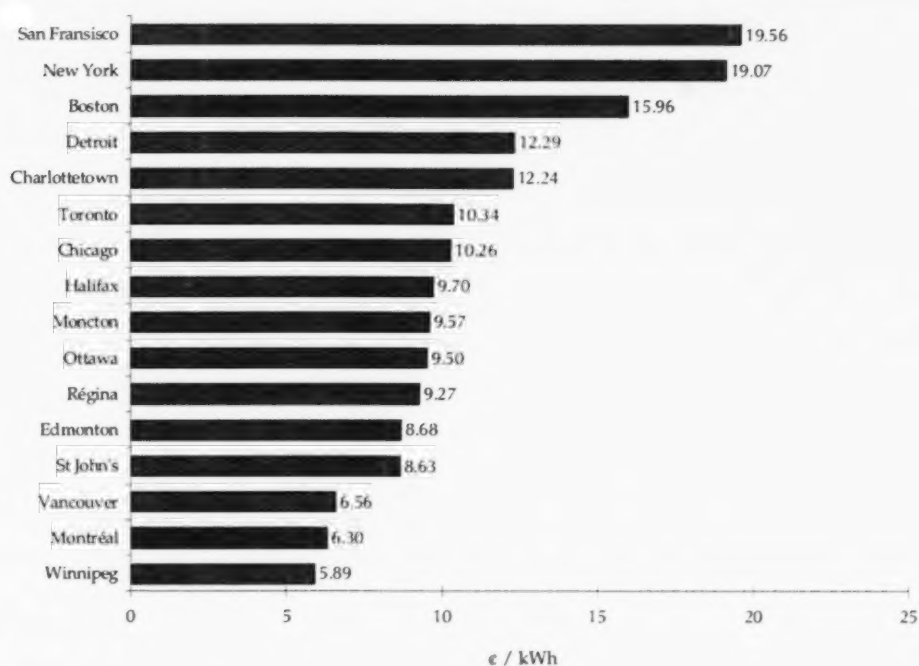
March 16, 2005

The Quebec Assembly's Labour and Economy Commission is currently holding public hearings on the future of Quebec's energy sector. A central issue is electricity prices, a subject on which everybody seems to have an opinion. Consumer groups oppose price increases because they hurt low-income families. Better-off Quebecers remain quiet because they, too, like low prices. Energy-intensive industries, eager to preserve their competitive advantage, also favour maintaining low prices. Politicians are only too happy to cooperate, and appropriate the easy political payoffs that flow from a low-price policy. Compared to other North-American jurisdictions, electricity prices in Quebec are indeed very low (Figure 1). For society as a whole, however, maintaining electricity prices below their opportunity costs — the real economic costs — makes Quebec poorer. The underlying social pact must be rethought.

Quebec's energy potential is phenomenal, not only because of its many indigenous sources, but also because it can apply the experience and competency it has acquired, as well as developing potential new markets. However, a poorly informed coalition of legislators, business and union leaders exercise inordinate control over its energy resources. The result is a misdirected resource-development policy, based on price manipulation, that benefits only the groups directly involved, while squandering the potential gains from a socially optimal resource-exploitation plan. That is a policy that can lead to collective impoverishment. The current low-price policy — implying higher public debt and taxes, and possibly leading to a deterioration of social services — is not only an inefficient subsidy to big energy consumers, including both individuals and corporations, but also a regressive transfer from poor to rich.

Commentators often hail the relatively low level of electricity prices in Quebec as helping achieve a high level of economic development. What that hides, however, is the real social cost of the policy. The real price of electricity is not its production cost, particularly low in Quebec because of plentiful hydro-electric power, it is its opportunity cost. That cost is significantly higher because it equals the maximum competitive price at which electricity can be exported. The traditional response of consumer groups that gain from this policy is: *Everybody benefits from low prices*. Nothing could be further from the truth.

Figure 1: Comparison of Electricity Prices in North America — Residential Customers (April 2004)



Source: Hydro-Quebec (2004).

If the authorities were to offer Montreal households that consume 12,000 kilowatt hours (kWh) per year at a cost of \$756, the option of cutting their electricity consumption by 10 percent (1,200 kWh), using means that are not onerous, in exchange for lowering their electricity bill by 20 percent, a \$151 saving, a great majority of consumers would accept. They would do so because the agreement would be realistic in view of the prices that prevail in surrounding jurisdictions. The true cost of the last 1,200 kWh to this household would be \$151, or 12.60 cents per kWh. To withhold such an option is unfair because it induces the family to consume 1,200 kWh at the apparent but misleading price of 6.30 cents per kWh, while the real cost is more than twice that. Hydro-Quebec calculates that selling electricity at market prices would generate \$5.3 billion more for the government.

The real social cost of selling electricity at a subsidized price lower than its opportunity cost is that it promotes the development of energy-intensive economic activity, producing distortions in industrial activity. It also sends signals that are unfavorable to sustainable development. To top the irony, Quebecers must now spend tax dollars to finance government programs that promote energy conservation.

We should rely on the cheapest, most equitable, most effective and most efficient mechanism to create the right level of conservation: a price equal to the real economic cost. If the government wants to alleviate the impact on lower-income households, it can use the appropriate income redistribution mechanisms

that are already in place, combined with incentive programs, to shelter them from the price increases.

Politicians, industrialists and union leaders often argue that low electricity prices help create jobs, while neglecting to mention other employment opportunities that are forfeited. The reason is clear: the benefits are easily observable and can be easily appropriated by well-organized political and industrial organizations, while the costs are diffuse and distributed through the entire population, typically poorly organized and misinformed. I would cite as proof the efforts put forward to prevent any transparent evaluation of the social losses that the low-price policy engenders. How can Quebec deploy so much effort on fiscal imbalance and equalization when it could probably do without the latter through better use of its natural and human resources?

Quebecers should militate for policies that would lead to true wealth creation. To achieve that, some important changes are in order. For one thing, government should allow transparent and independent analysis of the true costs and benefits of Quebec's current energy policy. For another, it should let the price of electricity rise and reflect its true opportunity cost. As well, it should allow as much energy development of electricity, natural gas and oil as is compatible with security, environmental protection and profitability targets. Let's hope the parliamentary commission on energy facilitates such policies.

Reference

Hydro-Quebec. *Comparison of Electricity Prices in Major North American Cities - Rates Effective April 1, 2004*. [Online][http://www.hydroquebec.com/publications/en/comparison_prices/2004/pdf/comp_2004_en.pdf] (March 15, 2005)
